Sheffield, United Kingdom

Grants and loans for social enterprises

Based in South Yorkshire, England, the Key Fund has been providing grants, loans and equity finance packages to social enterprises and voluntary groups in the region for over a decade. Its dual aim is to help social enterprises which have traditionally been unable to access mainstream finance, and to boost business creation in socially deprived areas. Recent years have seen a push in the fund towards loans (or a mixture of loans and grants) over pure grants, with the effect of instilling in social enterprises a keener business imperative.

Grants and loans for social enterprises

The Key Fund, based in South Yorkshire, has been providing grants, loans and equity finance packages to social enterprises and other groups in the third sector since its establishment in 1999. As both a social enterprise itself and one of eight Community Development Finance Institutions in the Yorkshire and Humber region, it aims to help social businesses that are unable to access mainstream finance and to boost business creation in socially deprived areas. Part of its role is to encourage the model of social enterprise.

Between January 2011 and May 2012, the Key Fund has made 65 loans up to €30k, 15 between €30k and €120k and one over €120k. Delinquency rates are low and 70% of the fund's investments are to organisations located in or that reach into the top 20% most deprived areas. As a proportion of its turnover, the two ERDF projects it currently manages are quite small, with a combined value of €16 077 of ERDF money with match funding of €16 463. The projects are performing well against targets.

The Key Fund provides a highly effective service that balances responsiveness and relationships with the locality with sound investment principles. Its innovative blend of grant and loan has simplified business start-up and growth for social enterprises and provided a keen business imperative. Several stakeholders believe that the model provided by the Key Fund is transferable outside the region, and the example it sets, of nurturing social enterprise with a mixture of grants and loans, is one that should inspire a spectrum of instruments to promote financial inclusion.

Grants and loans for social enterprises

Based in South Yorkshire in northern England, the Key Fund[1] provides a unique and flexible blend of grants, loans and equity finance to support voluntary groups, voluntary and community organisations, cooperatives, social entrepreneurs and social enterprises in the region. The fund aims both to create a market and to serve it: it encourages social enterprise as a model, and extends services to support the start-up and growth of businesses that have been unable to access mainstream finance. The Key Fund is currently leading two ERDF projects in the region that aim to fill a gap in the market by providing small grants and loans to social enterprises which will in turn create jobs and growth.

The Key Fund is itself both a social enterprise and a Community Development Finance Institution (CDFI).[2] CDFIs are specialist enterprises, often operating on a not-for-profit basis, delivering finance and other support services to enterprises and individuals. They have an explicit social welfare mission, for instance focussing their lending on disadvantaged areas and/or amongst financially excluded groups. The Key Fund works alongside seven other Community Development Finance Institutions in the Yorkshire and Humber Loans project funded by the ERDF 2007-2013 regional operational programme.

Typical social enterprises that receive support from the Key Fund are active in advocacy and training, the food business, (cafés, drop-in centres, community pubs), provision for young people and families, community sports and arts services, the low-carbon economy (micro-generation of renewables in small businesses, community and decentralised energy plans, electric car clubs), recycling and waste businesses.

Rooted in the ERDF

The Key Fund concept dates back to 1998 when it started as an informal partnership giving grants from the South Yorkshire Objective 2 programme, the Single Regeneration Budget, the Training and Enterprise Council and the Coalfields Regeneration Trust to third sector organisations. It had a budget of €4 million between 1998 and 2001. Isobel Mills at the Government Office for Yorkshire and Humber then advocated a simplified grant and loan scheme under the South Yorkshire Objective 1 programme in response to the difficulties faced by community groups in accessing and delivering EU-funded projects and by social enterprises in establishing and growing social impact businesses. The idea was to do the match funding at source and have a simplified application process with simple outputs and quick, locally-made decisions. The approach had strong support from the then Director-General of DG REGIO.

The Key Fund was set up as a company in 2002 and received a €10.2 million contract to deliver regeneration activity with a mix of EU and national funds. In 2004 the fund successfully applied to the Phoenix Fund,[3] winning one of the largest awards at €1.2 million. Since then it has evolved its services and expertise in serving the social enterprise market.

The current ERDF contracts are to deliver flexible grant, loan and equity packages to SMEs and social enterprises in the region that have difficulty accessing mainstream finance. The focus is on loans, which will increase the level of capital available to CDFIs to build their own sustainability.

[1] http://www.thekeyfund.co.uk/
[2] http://www.cdfa.org.uk/about-cdfis/
[3] http://webarchive.nationalarchives.gov.uk/20040722012352/sbs.gov.uk/phoenix/

As well as managing the ‘Key Fund Social Enterprise Fund’, the Key Fund is the lead partner of a consortium project, ‘Yorkshire and Humber loans’, both running between 2010 to 2013 and funded by the 2007-2013 regional operational programme. In the consortium project each of the eight partner CDFIs operates directly with lenders in a defined geographical patch and provides its own match funding from a mixture of sources, such as regeneration and charitable funds. It will create regional coverage of a standard loan product.

The target outputs for the two projects combined are:

Gross new jobs created	1 813
Gross jobs safeguarded	362
New businesses created	420
Gross increase in GVA (gross value added)	€4.73m
No. of businesses assisted that are SMEs	1 195
No. of businesses assisted that are social enterprises	120

The combined budgets are €16 077 from the ERDF with match funding of €16 463. The projects are performing well against targets. Between January 2011 and May 2012, the Key Fund has made 65 loans of up to €30k, 15 of between €30k and €120k and one of over €120k.

The grant + loan model

The Key Fund model is to raise money to lend and grant on to other organisations. The fund has 12 staff, five of whom are client officers and spend half their time out and about in the region working face-to-face with social enterprise applicants and recipients. There is a monitoring officer, two finance staff, a marketing officer, the CEO and her PA. The board has nine directors.

An Investment Panel meets to review applications from SMEs and social enterprises on the last Friday of the month. The panel comprises four of the directors and five co-opted members taken from community organisations, social enterprises and in one case from NatWest bank. It reviews awards, updates members on the national, local and regional context and looks at management reports, deal flow, and performance in regard to delinquencies and defaults. Papers are circulated in advance.

Each client officer presents a standardised, detailed assessment of the applications they have dealt with, including a proposal with regard to a loan/grant split, amounts, interest rates and conditions. Occasionally, for instance when a larger loan is being applied for, a representative of the applicant organisation attends the panel. Hugh Rolo, chair of the Key Fund and a high-profile champion in the sector, stresses the importance of having the development team in the panel to keep close communication with the investors.

The level of loans is from €1 120 to €30 000 for businesses in deprived communities (in exceptional circumstances up to €60 000) and up to €60 000 for social enterprises. The minimum term is six months, the maximum term five years, and a repayment holiday of up to six months is available (subject to approval). With the exception of loans to social enterprises, any request for a loan in excess of €30 000 is referred to a separate body, Finance Yorkshire, which administers larger budgets. State aid rules mean that the interest rates offered on loans have to be 4% above the hurdle rate. The ERDF project application states the range will be between 11 and 14%. For the sake of simplicity most loans are agreed at a 6.5% flat rate, which works out at 12.5% APR. Since the Key Fund is a lender of last resort, applicants have to show proof that they have been refused credit elsewhere.

The blend and ratio of loan to grants has changed over time from one to one (i.e. parity) to three to one i.e. an applicant business is offered a package of 75% loan and 25% grant. More recently the ration has been taken up to four to one. This gradual push towards loans has encouraged social enterprises to be less grant-dependent, less risk-averse, and more commercially driven. As one applicant says, 'With a loan you have to be sure about your demand, and sure about your order book and sales.' Key Fund grants are only awarded to new social enterprises that have been trading for less than three years. The Key Fund rarely acquires equity[4] in a business; equity funding is underperforming generally across the social enterprise sector, as it is less suitable for raising small amounts. In the Key Fund's analysis for February 2012, only 5.35% of financing was in the form of equity.

Around eight to ten deals are presented at each meeting of the Investment Panel. The Chair of the panel signs the documents at the end of the meeting and loans are issued quickly. In February 2012 the average time between initial enquiry and loan issuance was just a day over four weeks. Repayments are collected by direct debit on the same day every month from projects. If an organisation struggles to repay, the loan officers may make a visit to renegotiate terms and help resolve the situation. The philosophy is to help people to survive, so often the loans are repackaged.

An external evaluation of the Key Fund conducted in 2011 concluded that it is 'highly regarded as an efficient and professional provider of essential and carefully designed products and services, an exemplar of a well-managed and effective social enterprise and a lobbyist on behalf of and a source of information and ideas about the social enterprise sector'. [5]

Low delinquency

The Fund has paid out €4.2 million over the last five years and this year expects €0.6 million back. In 2012 it expects to pay out €4.8 million and in 2013 it will get a third of that amount back. In 2011 €0.6 million worth of deals were left untaken, partly because applicants managed to find finance elsewhere, or in some cases because they were unable to fulfil the conditions imposed on them by the Key Fund.

Delinquency rates are low. Each month the loan portfolio is analysed. The data for February 2012 showed that in relation to outstanding loans of €3 850 000, 77.6% were performing, 13.5% were managed, 4.2% were delinquent and 4.8% were proposed write-offs. The Key Fund has only once sought closure of a company, and would avoid it in future as it was a messy, expensive process. A freelance specialist spends one day a week overseeing delinquent companies. Ann Oldroyd, the Chief Executive, reports: 'The specialist looks at the accounts, visits the projects and recommends packages. It's very good to keep that function separate from the rest of the team.'

Immediately after the panel a debriefing is held with the staff team to confirm follow-up actions and clarify which part of the amalgam of funds available the loan should be taken from. Conditions for each deal are clarified (e.g. planning permission, evidence of procurement, improved business plan). The Finance Manager checks the timing of loan defrayments out of Key Fund accounts, in order to forecast

[4] Equity here refers to shares in companies. Most social enterprises are structured without share capital and so shares are not a viable option. There are forms of quasi-equity and more complex company structures with A and B holdings whereby the social nature of control is preserved while allowing some share ownership.
[5] *Evaluation of Key Fund Yorkshire's Services Jan 2007–Dec 2009*, Viewpoint, 2010.

cash flow and claims to the managing authority. To monitor effectiveness in targeting disadvantaged communities, the team tracks interventions according to the Index of Multiple Deprivation.[6] Seventy percent of interventions are either located in or reach into the top 20% most deprived areas.

Policy alignment

The Key Fund model addresses a number of EU and national policy goals, including those for enterprise, especially entrepreneurship in under-represented groups, financial inclusion, the ConDem coalition's 'Big Society' (civic involvement/volunteering), localism, decentralisation of services, innovation, long-term unemployment and employability, climate and energy targets, e.g. community and decentralised energy plans. It is also in accord with the UK government's push of the third sector towards loans or loan-and-grant blend and away from pure grants.

The Yorkshire and Humber region has suffered for decades from the decline of steel and other manufacturing industries, and has high levels of unemployment. Social enterprise can be a trigger to support new business models and markets with a bottom-up, community-led approach. In the economic crisis it is increasingly difficult for individuals and groups to access finance and credit, especially if they live in disadvantaged areas and have no credit history. According to Isobel Mills, now Director of the regional office of the Department for Business Innovation and Skills, 'The Key Fund succeeds in getting resources quickly and in a streamlined way to social enterprises so that they can create jobs and growth.'

The fund works with sector and regional stakeholders such as the Charity Bank, Finance Yorkshire, the Community Development Finance Association (CDFA), Business Link, business support services and others to make cross-referrals, ensure a joined-up service, share intelligence and advocate better resourcing for this model.

Graham Pearce of the managing authority, the Department for Communities and Local Government, stressed that the project meets regional objectives. The ERDF adds value, ensures a focus on the most financially excluded and pump-primes the social enterprise market. 'We wanted the CDFIs to take the extra risk. ERDF alongside their own funds enables them to be more risky… Without Key Fund products, organisations are starved of cash in a recession. It's important that the ERDF gets out there to hard-to-reach, disadvantaged communities. This is about how we meet need in the marketplace. Banks have not been lending. They are still not lending to people with no track record or trading history. This is about tackling financial and social exclusion.'

Financial fund or 'project'?

The original intention and application to the ERDF operational programme was to run the initiative as a Chapter 15 financial engineering instrument.[7] However, the Key Fund and the other Community Development Financial Institutions had insufficient match funding to capitalise the funding without losing their working capital. Accordingly, a project structure, as opposed to a fund operating structure, was adopted, and the ERDF is paid in arrears once the loans have been paid to applicants.

[6] http://www.communities.gov.uk/communities/research/indicesdeprivation/deprivation10
[7] Chapter 15 of the ERDF User Manual gives guidance on financial engineering instruments.

Graham Pearce commented on the differences: 'Financial instruments have a fund operator and a fund manager. Such an arrangement is more costly and administrative as two organisations are top-slicing it. The fund operator gets a fee for lending, capped at 4% by ERDF rules and effectively acts as a broker.' The managing authority has set the management fee for the Key Fund as lead partner of Yorkshire and Humber Loans at 3.5%. This provides a built-in incentive to lend more and to keep revenue costs down. The attrition rate[8] is low at the Key Fund as its panel is compelled to be highly rigorous in assessing applicants if it wants to get the money back. Other regional fund operators have gone back to DG REGIO to say they can't manage the fund within the 4% capped fees, as it is labour- and time-intensive to work with the target groups.

The returns from loans are held with the Key Fund (as with each Community Development Financial Institution in the consortium). The managing authority reviews returns on an annual basis and, depending on performance, allows retention of 70-100% of receipts to use within the spirit and ethos of the Key Fund's constitution. This helps build up capital reserves to sustain and grow lending potential for the future.

Impact on communities

The recipients of Key Fund loans and grants are social enterprises, voluntary and community groups in the Yorkshire and Humber area. The Key Fund targets entities based in areas with high levels of deprivation serving disadvantaged and underrepresented communities and individuals. A high proportion is in urban areas. In many cases the social enterprises employ people and give placements to volunteers who may otherwise be far from the labour market, such as disabled people, ex-offenders, long-term unemployed, and Black, Asian and other minority ethnic people.

One recipient of Key Fund support is the JADE[9] organisation, a social enterprise serving young people based in Kiverton Park, Rotherham. JADE aims to provide positive opportunities for young people through the medium of music and performance as an alternative to the street culture of the area. Kiverton is an ex-mining village and has problems of unemployment, poor health and antisocial behaviour. JADE started out by running music events and developed into an innovative space and service run by and for young people. As a result of Key Fund intervention JADE now has rented premises (a 'living room on the high street') where young people can drop in, with an IT suite, music and dance studios.

JADE has won a number of contracts for outreach programmes in schools employing local staff to work with young people on preventative measures to tackle drugs, alcohol and personal and community safety. It is now the lead organisation of a new consortium that includes the police, the local authority and NGOs to open a second centre in a neighbouring town. Sam Oldroyd, co-founder of JADE, says: 'The Key Fund helped out when money got tight and things got sticky due to a grant payment being

[8] The attrition rate is the loss of repayments to the fund as a result of delinquencies and other non-payments.
[9] http://www.jadehq.co.uk/

late. It all came together in a perfect storm and we really didn't think we would make it.' JADE applied for a €6 000 loan, which is on track to be repaid in full in 2012, and a €6 000 grant. 'The Key Fund recognises that what we are doing is good. The new centre is a very good opportunity. The stage is now set. We are now in a better situation than ever before.'

Speakup[10] is another recipient of Key Fund support. This is a social enterprise established in 1998, as a national voice for change, employment and advocacy for people with learning disabilities. Based in Rotherham, it has been supported by the Key Fund for over 10 years, and received three grants and loans in that period. Speakup hosts a number of small social enterprises offering award-winning consultancy and training to health and social care professionals. It produces DVDs about enabling inclusion, and provides services in 'easy-read authoring' for government departments such as the Ministry of Justice. It also supports other self-advocacy groups in the UK and offers lay inspectors for the Care Quality Commission. All the services provide employment for people with learning disabilities.

Chief Executive of Speakup Adrian Harper said: 'The Key Fund loans were a crucial support. They helped us to retain staff and sustain employment of people with learning disabilities. Of course we would prefer a larger grant element, but it's a different world now. Everyone is pushing loans. We are not risk averse. For us, the only way forward is self-sustainability, not chasing contracts.' Harper noted too that there are some benefits to loan rather than grant support. 'Having a loan from the Key Fund gives a bit of breathing space, because the money isn't tied down to the last paperclip like traditional grants.'

Successful relationship banking

The Key Fund's success comes from having turned the experience of the past 10 years[11] into a highly effective service that balances responsiveness in a market tacking social need with sound investment principles. As Isobel Mills puts it, 'They are grounded in society but mindful of business.'

Chief Executive Ann Oldroyd explains that the ethos is of 'relationship banking,' working with people to get them investment ready, and able to maintain repayments, in a context where the Key Fund is their only chance of financial support. 'The organisations we support are not bankable in the traditional sense. These businesses make slower progress in generating financial returns. Social enterprises recruit from the long-term unemployed and disengaged. They are risky. Banks don't understand them. We have to listen, be patient, and be prepared to take risks.' This supportive approach is counter-

[10] http://www.speakup.org.uk/

[11] see press article on the Key Fund's 10th birthday: http://www.guardian.co.uk/uk/the-northerner/2012/oct/22/socialenterprises-key-fund-sheffield-leeds-bradford-doncaster-barnsley-rotherham

balanced by robust systems, policies and procedures, transparency and good due diligence.[12] 'We have to get the balance right; we have to be a safe pair of hands for public money.'

The fund puts simplicity and customer focus at the heart of its client-facing work, and as far as possible protects recipients from bureaucracy, helped by efficient back office systems and teamwork. It reacts quickly and flexibly, for instance providing bridging and cash flow finance in a matter of days or weeks, which can be crucial for whether an SME goes under or not, or is able to seize a business opportunity. One example was a small music business that had successfully applied for an Arts Council grant to go to the South by South West Festival in the US to market its products, but would not receive the funds in time to book the flights. For the Key Fund it was a quick and easy decision to say yes.

The local knowledge of the board, staff team and panel members means that their decisions are backed by a sound understanding of the context in which the loan and grant recipients operate. The board has a good mix of expertise: social entrepreneurs, commercial banks, investment specialists and community organisations.

The Key Fund has considerable sector, industry and local credibility. The management team and board regularly respond to requests for advice and training. Ann Oldroyd is an expert on the European Commission working group looking at common standards for non-mainstream microlenders.

Coping with recession

The Key Fund team is aware, however, that public relations and marketing are weaknesses. Their strategy to counteract this includes dedicating resources to raising the profile of investment successes among social enterprises and SMEs in the region.

The diversity of their clients makes it a challenge to understand such a range of businesses. Their solution is to have specialists in the team, for instance geographical or sectoral, and to support mutual learning within the team. Deal flow is not steady or predictable. It can be 'feast or famine'. The solution is to encourage flexibility in the team around tasks. The whole process is labour and time intensive. The small deals take as much time and effort as the large ones.

Graham Pearce feels that raising understanding in the voluntary and community sector about the need for loan models to replace grant finance is still a problem. A parallel ERDF-funded initiative called 'Understanding finance', in which the Key Fund is a partner, runs events and 'toolbox' talks to get people into workshops educating boards and trustees of charities and social enterprises.

Mr Pearce adds that the Yorkshire and Humber Loans consortium approach was a challenge at the outset. A good deal of consultation and negotiation was needed to reach a common accord about procedures. The solution was a project-specific quality manual for payment claims and audit. The Key Fund is the lead applicant because it has the most experience. 'Once you get your foundations right, then the rest is easy. There is a good management structure and a good division of roles. The leadership of the Key Fund is important. I attend consortium meetings with a bullet-proof vest!'

Adrian Harper of Speakup commented on the negative impacts of the recession and the way that austerity measures are leading to the reorganisation of services and public sector outsourcing. 'Some of the calls for tender have inadequate resources and this sets them up to fail. The impact of these reduced tenders is to neglect those furthest away from the job market. You lose that added value when service providers do not have a mission close to their heart. Some will hit the easy targets first. It all becomes target and numbers driven. The workers are on a minimum wage and you get the 10-minute intervention of home carers, for instance, that we have seen in the news lately.'[13]

[12] Due diligence is the process of checking credit worthiness and financial robustness before a loan is made.
[13] A recent newspaper account showed that home helps often had only 10 minutes with their elderly clients.

Partly as a result of the recession the Key Fund has had to develop a new level of scrutiny on the contracts it gives to social enterprises, to scrutinise the question of whether it is possible to deliver for the money offered. 'It's important that people are paid properly and that the social enterprise maintains its reputation and stability,' says Gillian Dinsey, Client Officer. 'Social enterprise has a focus on the client group, not the bottom line, but the Key Fund support can help to improve business skills.'

As part of the UK's Localism Act[14] of April 2011 and 'transforming local infrastructure ' policies, there is a shift to decentralise services and empower communities to own and control local assets, such as buildings and spaces. This represents an opportunity for social enterprises, and asset transfers from local authorities can provide the match funding for ERDF grants. But there is a fear it will prevent many social enterprises from entering the market if the prices, financing mechanisms and management models are not right or are too inflexible.

Social enterprises can be more expensive than traditional private sector business models but they can also have greater social returns. One of the challenges for the Key Fund is to implement an agreed system of measuring and monitoring social impacts. The Key Fund has done work on social return on investment and is familiar with some of the formulas available to calculate percentage value and monetary value of social impacts. 'We need some help to integrate social impact measurement. We need it for grant applications and to demonstrate our value in the widest sense. We would like to see the Community Development Finance Association[15] (the umbrella body for Community Development Finance Institutions) produce one system for social impact measurement.'

Sustainability is still a challenge, and a recent strategic Key Fund review set a target of a €9 million annual turnover to make the loan fund fully sustainable. This size of fund would help to generate enough reserves and revolving loans to operate without additional grants. Low interest rates as a result of the credit crunch have reduced the income from deposit accounts so the fund now has less income from its assets. This barrier to sustainability was documented by consultants who evaluated a range of CDFIs for the UK government.[16]

A transferable model for Europe

The Key Fund's staff and stakeholders firmly believe the model is transferable. One of the few potential barriers to transfer is the different political context in each region. Existing providers get nervous about defending their patch, and it is important that regional authorities are open to social enterprise solutions. The Key Fund is set to expand outside the region with the support of the Esmée Fairbairn Foundation. To enable this level of growth it will need to scale up its decision-making models and procedures.

Several stakeholders commented on the possibilities for European funds to learn from the Key Fund example and think radically about the tools needed to tackle financial inclusion and support social enterprise growth in the future. The view was that there would always be a need for some grant funding

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[14] http://www.communities.gov.uk/localgovernment/decentralisation/localismbill/
[15] http://www.cdfa.org.uk/
[16] *Evaluation of Community Development Finance Institutions*, GHK sponsored by Department for Business, Enterprise and Regulatory Reform and Office of the Third Sector[16]

alongside loans, and for technical assistance like the Key Fund to support and nurture the social enterprise market, which is still underperforming, to become investment ready. More advice and guidance are needed from peers in the sector.

One possibility is that a European programme could be created to support a whole spectrum of financial instruments to promote financial inclusion. These could include support for credit unions, financial literacy, corporate volunteering, grants, loans, bonds, social investment accounts and social impact bonds. Services like the Key Fund could have a high-street presence like credit unions and an adviser on site one day a week to compete with banks and penetrate the market. Graham Pearce had strong opinions: 'We should be seeing community banks and other services in a one-stop shop, competing aggressively in that market. They should replace the awful 'payday loans' with outrageous interest rates. This is about getting money into those communities that suffer financial exclusion and are vulnerable to exploitation.'

Major economic opportunities exist, as well as obvious emerging high-growth sectors well suited to social enterprises, especially in the low-carbon economy and adult social care. Several stakeholders expressed the view that the current market has no plurality. Public sector contracts are still dominated in the UK by a small number of large private-sector companies. It is difficult for social enterprises to crack that market, and there may be a need for more interventionist policies, such as targets in public procurement, to create a more level playing field. In particular, the new type of public contracts based on 'payment by results' have an inherent entry barrier for social enterprises that lack sufficient working capital to even get started.

It was also felt that EU state aid rules need to be rewritten; such rules are inapplicable in a time of recession. Radical innovation and new frameworks need to be created that encourage hybrid partnerships to emerge with new business models and paradigms.

The Key Fund's innovative blend of grant and loan has simplified business start-up and growth for social enterprise. It has succeeded in positioning social enterprises as businesses, not just social and 'fluffy' ideas. It has also proven that loans can have a transformational impact in a region.

AEIDL has been contracted by the European Commission in 2012 in order to provide examples of learning practice in urban development supported by the European Regional Development Fund during the 2007-2013 programming period (contract reference 2011.CE.16.0.AT.035). The views expressed by AEIDL remain informal and should not under any circumstance be regarded as the official position of the European Commission.